IN THE HIGH COURT OF PUNJAB AND HARYANA AT CHANDIGARH

Income Tax Appeal No.138 of 2004
Date of decision: October 16 , 2006

M/s Munjal Sales Corporation, Hero Nagar, G.T. Road, Ludhiana

v.

Commissioner Income Tax (Appeals), Central Circle- I Ludhiana and another

Present: Mr. Akshay Bhan, Advocate for the appellant.
Mr. S.K.Garg Narwana, Advocate for the respondents.

CORAM:
Hon'ble Mr.Justice Adarsh Kumar Goel
Hon'ble Mr. Justice Rajesh Bindal

Rajesh Bindal, J.

This appeal by the assessee is directed against order dated 25.11.2003 passed by the Income-tax Appellate Tribunal, Chandigarh Bench `B' (for short, `the Tribunal') in I.T.A. No. 269/CHANDI/99, for the assessment year 1994-95, raising the following substantial questions of law:

> "(i) Whether in the facts and circumstances of the present case, order vide Annexures P.1 to P.3 are based on mis-appreciation of facts and law involved in the case and liable to be set aside, especially when the provisions of Section 36(1)(iii) of the Income Tax Act, 1961 are not applicable in the instant case ?
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> (ii) Whether in the facts and circumstances of the case, the action of the authorities below in disallowing the interest of Rs. 2,49,002/- being 15% of the total amount of Rs. 16.84 lacs advanced by the appellant/ assessee to its sister concern, without consideration of this important fact that the assessee/appellant is earning profits of more than 1 crore and therefore the interest free loan is far below than the amount of profit earned in the relevant assessment year 94-95, is liable to be set aside ?
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> (iii)Whether the action of the authorities below in disallowing the interest free loan so advanced by the assessee/appellant to its sister concern without specifying as to from which claimed of interest paid, the disallowance has been made, is unsustainable, perverse and liable to set aside ?
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> (iv) Whether in the facts and circumstances of the present case, the action of the authorities below in disallowing the interest of Rs.

2,49,002/- without considering the fact that all the advances so made were old ones and no advance was made during the assessment year 94-95, is arbitrary, erroneous and is liable to set aside ?

(v) Whether in the facts and circumstances of the present case, the action of the authorities below in disallowing the interest for the relevant assessment year 94-95, when the same had been fully allowed in the previous year, is perverse and unsustainable at law ?

(vi) Whether the action of the authorities below in disallowing the interest in the hands of the firm and simultaneously not allowing any relief in the hands of the partners by reducing the interest taxable in their hands by the same amount, without considering the provisions of Section 28(v) of the Income Tax Act, 1961, so as to avoid double taxation of the same income, is unsustainable in the eyes of law and is liable to be set aside ?

(vii) Whether in the facts and circumstances of the present case, the action of the Ld. Tribunal in allowing the telephone expenses so claimed by the assessee/appellant partly and not fully, is arbitrary and merits reconsideration ?

(viii) Whether the action of the authorities below acting of its own presumption is legally sustainable ?

(ix) Whether in the facts and circumstances of the present case, the advancement of the interest free loan by the assessee/appellant to its sister concern, is in due course of business, is legally sustainable ?

(x) Whether the action of the assessing officer in excluding its jurisdiction by acting merely on its presumption and right in the eyes of law ?

(xi) Whether in the facts and circumstances of the case, Annexures P.1 to P.3 are legally sustainable?"

The assessee derived income mainly from commission as sole selling agent of Hero Group of Companies. During the course of assessment, it was found that there were outstanding loans against M/s Brij Mohan Lal and Associaties and M/s S.K.Rai and Sons, on which no interest was charged by the assessee. The plea raised by the assessee that advances were not made out of the borrowed funds carrying interest, was not accepted by the Assessing Officer and interest to that extent was disallowed. In appeal, the plea raised by the assessee that it had

sufficient balance in the partners capital, amounts standing in the credit as unsecured loans etc. and accordingly the sums could be advanced on interest free basis out of these funds, was not accepted and the appeal was dismissed. The assessee went in appeal before the Tribunal against the order passed by the Commissioner of Income-tax (Appeals), where also the assessee failed to establish from any evidence or material on record to show that the amounts in question were advanced to sister concern out of its personal funds, which were carrying no interest burden thereon or that there was any business purpose for advancing the loan on interest free basis. Even the plea of the assessee regarding treatment of the capital of the partners to be available for advances of interest free loans was also negatived.

We have already considered an identical issue in Commissioner of Income-Tax v. Abhishek Industries Ltd., (2006) 286 ITR 1, wherein this Court held as under:

> "As far as the issue of establishment of nexus of the funds borrowed vis-a-vis the funds diverted towards sister concern on interest free basis is concerned, in our view, the stand of the assessee that the onus of proving the nexus of funds available with the assessee with the funds advanced to the sister concerns without interest is on the Revenue is not correct. Section 36(1)(iii) of the Act provides for deductions of interest on the loans raised for business purposes. Once the assessee claims any such deduction in the books of accounts, the onus will be on the assessee to satisfy the Assessing Officer that whatever loans were raised by the assessee, the same were used for business purposes. If in the process of examination of genuineness of such a deduction, it transpires that the assessee had advanced certain funds to sister concerns or any other person without any interest, there would be very heavy onus on the assessee to be discharged before the Assessing Officer to the effect that inspite of pending term loans and working capital loans on which the assessee is incurring liability to pay interest, still there was justification to advance loans to sister concerns for non-business purposes without any interest and accordingly, the assessee should be allowed deduction of interest

being paid on the loans raised by it to that extent. In our view, even the plea of nexus of loans raised by the assessee with the funds advanced to the sister concerns on interest free basis, may be it is pleaded to be out of sale proceeds or share capital or different account cannot be accepted.

Entire money in a business entity comes in a common kitty. The monies received as share capital, as term loan, as working capital loan, as sale proceeds etc. do not have any different colour. Whatever are the receipts in the business, that have the colour of business receipts and have no separate identification. Sources has no concern whatsoever. The only thing sufficient to disallow the interest paid on the borrowing to the extent the amount is lent to sister concern without carrying any interest for non-business purposes would be that the assessee has some loans or other interest bearing debts to be repaid. In case the assessee had some surplus amount which, according to it, could not be repaid prematurely to any financial institution, still the same is either required to be circulated and utilised for the purpose of business or to be invested in a manner in which it generates income and not that it is diverted towards sister concern free of interest. This would result in not presenting true and correct picture of the accounts of the assessee as at the cost being incurred by the assessee, the sister concern would be enjoying the benefits thereof. It cannot possibly be held that the funds to the extent diverted to sister concerns or other persons free of interest were required by the assessee for the purpose of its business and loans to that extent were required to be raised. We do not subscribe to the theory of direct nexus of the funds between borrowings of the funds and diversion thereof for non-business purposes. Rather, there should be nexus of use of borrowed funds for the purpose of business to claim deduction under Section 36(1)(iii) of the Act. That being the position, there is no escape from the finding that interest being paid by the assessee to the extent the amounts are diverted to sister concern on interest free basis are to be disallowed.

If the plea of the assessee is accepted that the interest free advances made to the sister concerns for non-business purposes was out of its own funds in the form of capital introduced in business, that again will show a camouflage by the assessee as at the time of raising of loan, the assessee will show the figures of capital introduced by it as

> a margin for loans being raised and after the loans are raised, when substantial amount is diverted to sister concerns for non-business purposes without interest, a plea is sought to be raised that the amount advanced was out of its capital, which in fact stood exhausted in setting up of the unit. Such a plea may be acceptable at a stage when no loans had been raised by the assessee at the time of disbursement of funds. This would depend on facts of each case.
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> Section 106 of the Indian Evidence Act or the principles analogous thereto places the burden in respect thereof upon the assessee, as the facts are within its special knowledge. However, a presumption may be raised in a given case as to why an assessee who for the purpose of running its business is required to borrow money from banks and other financial institutions would be giving loan to its subsidiary companies and that too when it pays a heavy interest to its lenders, it would claim no or little interest from its subsidiaries."

In view of the above, finding that the issue raised in the appeal being covered by the judgment of this Court, no substantial question of law arises. As the effect of the disallowance of interest in the hand of the assessee on the income of the partners to whom interest was paid having not been considered, we deem it appropriate to remit the matter back to the Tribunal for the limited issue.

As regards disallowance of part of telephone expenses installed at the residence of the partners is concerned, on estimate 1/7th thereof has been disallowed out of the total expenses. The Tribunal, while applying the cut, had followed the principles applied for the previous assessment year 1992-93. The same being on estimate basis, we do not find any justification to substitute our own view for estimation. Therefore, we do not find any merit in this plea of the assessee.

Accordingly, the appeal is disposed of.

(Rajesh Bindal)
Judge

(Adarsh Kumar Goel)
Judge

October 16 , 2006/mk

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